

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
MURRAY SCHWARTZ ) No. 89R-1266-JV  
)

Appearances:

For Appellant: Jerome R. Rosenberg  
Attorney at Law

For Respondent: A. Kent Summers  
Counsel

OPINION

This appeal is made pursuant to section 19057, subdivision (a),<sup>1/</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Murray Schwartz for refund of personal income tax in the amount of \$142,349 for the year 1986.

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<sup>1/</sup> Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

The main issue is whether appellant's stock in January Enterprises, Inc. (January), qualified as "small business stock" for purposes of the tax on items of preference income.

January was incorporated in New York in 1964. Appellant purchased shares of capital stock of January on April 1, 1985. January qualified to do business in California on April 7, 1986. It filed its first California franchise tax return for the period September 1, 1985, to May 5, 1986. January was the parent holding company of several subsidiaries, some of which operated wholly or partly in California. January's gross receipts were derived from its performance of general corporate overhead and administrative services for the subsidiaries.

On May 5, 1986, appellant sold his shares in January and reported the unrecognized portion of the capital gain as an item of tax preference. Appellant subsequently filed an amended income tax return claiming a refund of preference tax based on his contentions that the January stock was small business stock as defined by former section 18162.5 and that the gain on the sale was, therefore, entitled to the preference tax exclusion under former section 17063.11.

Upon review, respondent determined that the stock did not qualify as small business stock because neither January's commercial domicile nor its principal place of business were in California at the time appellant acquired the stock. Therefore, respondent denied appellant's claim for refund.

Former section 17062 imposed a tax on preference items as set forth in former section 17063. Former section 17063, subdivision (e), provided that the unrecognized portion of capital gains was an item of tax preference. However, under former section 17063.11, the unrecognized portion of capital gains attributable to the sale of small business stock (defined in former section 18162.5, subdivision (e)), was not an item of tax preference.

Former section 18162.5, subdivision (e), in pertinent part, defined small business stock as follows:

(e) For purposes of this section, "small business stock" is an equity security issued by a corporation which has the following characteristics at the time of acquisition by the taxpayer:

(1) The commercial domicile or primary place of business is located within California.

(2) The total employment of the corporation is no more than 500 employees . . . covered by federal unemployment insurance on December 31 of the year preceding acquisition of the small business stock. . . .

- (3) The outstanding issues of the corporations, including those held by the taxpayer, are not listed on the New York Stock Exchange . . . .
- (4) No more than 25 percent of gross receipts in the immediate prior income year were obtained from rents, interest, dividends, or sales of assets.
- (5) The corporation is not engaged primarily in the business of holding land.

Appellant has the burden of disproving respondent's determinations, which are presumptively correct. (Todd v. McColgan, 89 Cal.App.2d 509 [201 P.2d 414] (1949); Appeal of John Deere Plow Company of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961; Appeal of Thomas A. Beckett Investment Co., Cal. St. Bd. of Equal., July 22, 1952.) In order to take advantage of the tax preference exclusion provisions of section 17063.11, appellant must show that January met all the requirements of former section 18162.5, subdivision (e), at the time of his acquisition of the stock.

Appellant concedes that if we consider January alone, without considering its affiliated subsidiaries, January did not have the required characteristics for small business stock at the time of acquisition because it was not commercially domiciled in California nor was its primary place of business located within California. Appellant argues, however, that the question of January's commercial domicile should be determined by examining the entire "January chain" (January and its group of affiliated subsidiaries). Therefore, the first question we must answer in determining commercial domicile is whether we are limited to looking only at January's activities, or whether we may look at the activities of the entire January chain.

In support of his position, appellant primarily relies on First Bank Stock Corp. v. Minnesota, 301 U.S. 234 [81 L.Ed. 1061] (1937), and Southern Pacific Co. v. McColgan, 68 Cal.App.2d 48 [156 P.2d 81] (1945). Appellant argues that in First Bank Stock the United States Supreme Court held that it was permissible to look to the activities of a wholly-owned subsidiary to determine the commercial domicile of its parent. Moreover, appellant maintains that this principle is the law in California because the California Court of Appeals, in Southern Pacific, cited First Bank Stock as a case that established the doctrine of commercial domicile. However, upon review of First Bank Stock and Southern Pacific, we find that these cases are substantially different from the present appeal and do not provide any authority for appellant's position that we must look at the entire January chain in determining January's commercial domicile.

In First Bank Stock, the primary issue was whether the stock owned by the taxpayer had acquired a business situs in Minnesota, not whether the taxpayer was commercially domiciled in Minnesota. In First Bank Stock, the state of Minnesota levied a property tax on shares of stock in Montana and North Dakota banks owned by the taxpayer. The taxpayer was incorporated under the laws of Delaware, but was qualified to do business in Minnesota, filed tax returns in Minnesota, had offices in Minnesota, and transacted its corporate business and fiscal affairs in Minnesota. Because the

taxpayer was not doing business in Delaware, but rather in Minnesota, the Court held that the taxpayer was commercially domiciled in Minnesota. The primary issue then became whether the stock owned by taxpayer had acquired a business situs in Minnesota. On this issue the Court held that it was permissible to look to the activities of the taxpayer's wholly-owned subsidiaries to determine if their activities were so integrated with the parent that their stock had acquired a business situs in Minnesota.

In our view, First Bank Stock is significantly different from the present appeal. In First Bank Stock the taxpayer corporation was qualified to do business in the state of Minnesota and in fact Minnesota is where its entire corporate and fiscal affairs were conducted, including the filing of its tax returns. It was clearly commercially domiciled in Minnesota. In the present appeal, January was not qualified to do business in California, did not conduct its corporate business or fiscal affairs in California, and did not file California returns for the period in which the stock was acquired by appellant. In fact, appellant admits that it was not commercially domiciled in California. Once the Court determined the commercial domicile of the taxpayer in First Bank Stock, the Court held that it was permissible to look at the activities of the subsidiaries to determine the business situs of certain intangibles (stock of out-of-state banks) of the taxpayer. However, the determination of the commercial domicile of January itself, not the business situs of intangible assets, is the issue presented in the present appeal. Therefore, First Bank Stock does not provide any authority for appellant's position that we must look to the entire January chain.

Additionally, Southern Pacific does not provide any authority for appellant's position. As in First Bank Stock, the primary issue in Southern Pacific was not whether the taxpayer was commercially domiciled in California, but rather, whether California could tax certain intangibles (dividends on stock owned by taxpayer). In Southern Pacific the taxpayer corporation was operating a unitary railroad transportation business in California and six other states. In addition, taxpayer owned stock in other transportation companies, which stock was held in New York. The taxpayer argued that its stockholding activities in New York somehow constituted a separate enterprise from its unitary railroad business, which was clearly commercially domiciled in California, and that the commercial domicile for the stockholding activities was in New York, not California. The appellate court held that the stockholding in New York did not constitute doing business since there were no activities with respect to the stocks involved except the receipt and disbursement of dividends. The court also pointed out that most of the companies that the taxpayer owned stock in were directly connected with the taxpayer's unitary railroad transportation business. Thus, the court determined that there was no sound basis for holding that the New York stockholding activities constituted a separate business with a separate commercial domicile. Southern Pacific provides no more authority for appellant's position than did First Bank Stock.

We agree with respondent that this board must look only at January in determining commercial domicile. Respondent maintains, and we agree, that former section 18162.5 itself referred to the commercial domicile of the single corporation which issued the stock in question. The only time the statute directs that more than one corporation should be looked at is in subdivision (e)(2), which directs that the employees of a corporation controlling the subject corporation must be counted when

determining whether or not there were more than 500 employees at the time of stock acquisition. When a statute is clear on its face no interpretation is necessary, and the statute must be followed as written. (People v. Stanley, 193 Cal. 428 (1924); Wallace v. Department of Motor Vehicles, 12 Cal.App.3d 356 (1970); Appeal of Magnus F. and Denise Hagen, Cal. St. Bd. of Equal., Apr. 9, 1986; Appeal of Dorothy Shinder, Cal. St. Bd. of Equal., Aug. 30, 1967.) We see no ambiguity in this statute with regard to this particular issue.

Based upon the foregoing, we must conclude that there is no authority that allows us to look at January's chain of subsidiaries in determining the commercial domicile of January. Since January itself, as admitted by appellant, was not commercially domiciled in California at the time appellant acquired the stock, the stock could not qualify as small business stock. Therefore, the action of the respondent must be sustained.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Murray Schwartz for refund of personal income tax in the amount of \$142,349 for the year 1986, be and the same is hereby sustained.

Done at Sacramento, California, this 9th day of March, 1994, by the State Board of Equalization, with Board Members Mr. Brad Sherman, Mr. Matthew K. Fong, and Ms. Windie Scott present.

Brad Sherman\_\_\_\_\_, Chairman

Matthew K. Fong\_\_\_\_\_, Member

Windie Scott\*\_\_\_\_\_, Member

\_\_\_\_\_, Member

\_\_\_\_\_, Member

\*For Gray Davis per Government Code section 7.9.

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